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SUBJECT: PROMISING RESULTS FROM EU-UKRAINE GAS
INFRASTRUCTURE CONFERENCE

Sensitive but Unclassified - not for Internet distribution.

¶1. (SBU) summary. At the March 23 EU-sponsored conference on investment in Ukraine's gas infrastructure, Ukrainian Prime Minister Timoshenko and President Yushenko both attended and presented a united front pledging reform to the Ukrainian energy system. Russian Energy Minister Schmatko, who spoke before Yushenko's arrival, said "Russia is prepared to participate in the modernization of Ukraine's GTS, including financing." He criticized the declaration as "a radical departure from the current order; it raises a lot of questions for Russia." Representatives from the European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD), and the World Bank expressed their respective commitments to cooperate, but reiterated that reform was a prerequisite to financing. Ukraine (PM Tymoshenko), the Commission (Commissioners Ferrero-Waldner and Piebalgs), and representatives from EIB, EBRD, and the World Bank signed a joint declaration at the conference in which the financial institutions (IFIs) committed to start due diligence work on the projects identified in Ukraine's "Gas Transit System (GTS) Master Plan." In exchange, Ukraine committed to implement the reforms called for by the IFIs. Charge Murray led the U.S. delegation. End Summary.

¶2. (SBU) Prime Minister Timoshenko was the second speaker after EU External Relations Commissioner Ferrero-Waldner. She said the January gas cutoff by Russia was "political and not technical." She said modernization of the GTS, linking to the EU's grids, and conformity with European standards will "open new opportunities" for Ukraine. On the IFI's demand to unbundle the sector, she said that Ukraine's gas transit system "must remain in State hands in accordance with Ukraine law." President Yushenko arrived later with Commission President Barroso (and was seated next to Timoshenko during Barroso's speech). Yushenko said he was "determined to root out all kinds of corruption." He continued Ukraine is "fully aware of its responsibility" and identified three priorities: (1) replacement of outdated facilities, (2) installation of an internal and external metering system, and (3) access to Ukraine's gas storage facilities by European energy companies.

¶3. (SBU) Russian Energy Minister Schmatko spoke before Yushenko's arrival. He said "Russia is prepared to participate in the modernization of Ukraine's GTS, including financing." He criticized the declaration as "a radical departure from the current order; it raises a lot of questions for Russia." Noting the absence of any references to Russia in the joint declaration, he said the parties must coordinate their efforts with the supplier if they plan to expand the transit system and called for tripartite cooperation with "equal and equitable participation" for all. The acting director of Naftogaz also called for a tripartite

conference during a speech later in the day. Schmatko said the proposal to increase Ukraine's transmission capacity by 60 bcm was "not in line with the EU's policy of diversification of routes." He warned that "Ukraine could take advantage of its (transit) monopoly to the detriment of Russia," and called for a mechanism of international guarantees for supply and transit.

¶4. (SBU) Representatives from the European Investment Bank (EIB), European Bank for Reconstruction and Development (EBRD), and the World Bank expressed their respective commitments to cooperate, but reiterated that reform was a prerequisite to financing, with EBRD specifying that Ukraine must install an independent transmission operator who would act as a credible borrower. EBRD also called for third party access to Ukraine's transmission and storage systems, in accordance with the Energy Community Treaty. EIB said it was ready to start due diligence on a loan package without delay, provided Ukraine moves forward to implement reforms.

¶5. (SBU) Ukraine PM Tymoshenko, External Relations (RELEX) Commissioner Ferrero-Waldner, Energy Commissioner Piebalgs, and representatives from EIB, EBRD, and the World Bank signed a joint declaration in which the financial institutions (IFIs) committed to start due diligence work on the projects identified in Ukraine's "Gas Transit System Master Plan." In exchange, Ukraine committed to implement the reforms called for by the IFIs, notably Ukraine committed to:

-- Ensure the independence of the Ukrainian gas transmission operator in terms of its legal form, organization, decision making and accounts.

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-- Ensure transparency and openness of the borrower mandated for the modernization of the gas transmission system to ensure equal and effective access to the relevant financial and technical information as well as control of the use of funds allocated.

-- Allow the gas transmission operator to operate on a commercial basis for fulfilling its business development plans over the long term.

-- Ensure that tariffs for access to networks take into account the need for system integrity and its improvement and reflect actual costs incurred.

-- Provide for third party access to storage facilities under transparent commercial conditions and under the control of the regulatory authority.

-- Develop a "Gas Sector Reform Program" by the end of 2009 at the latest for the implementation of the gas sector reforms in 2010-1011 with deadlines that should match the commitments that will be entered into in the context of the EU-Ukraine Association Agreement and Ukraine's accession to the Energy Community Treaty, and are commensurate with the shared objective of attracting investments.

¶6. (SBU) After the VIPs departed, Naftogaz officials discussed funding needs based on Ukraine's "Master Plan" for gas:

-- 3.02 billion USD to rehabilitate/modernize Ukraine's GTS, including: 2.05 billion USD for gas pipelines; 455.3 million USD for underground storage facilities; 448 million USD for gas metering stations at all entry points to the GTS; and 63.6 million USD for gas metering stations at exit points of the GTS.

-- 5.55 billion USD to increase capacity by 60 bcm/a along the Novopskov-Uzhgorod and Torzhok-Dolyna pipelines.

¶7. (SBU) After the conference, Econ Officers met with a

DG-RELEX official who said they were pleased with the conference results. RELEX considered getting Timoshenko and Yuschenko on the same stage with complimentary messages to be a major political success. The official said he was not surprised by the Russian response, but considered it positive that Russia's energy minister showed up. The official also noted that the 5 billion USD project to boost capacity by 60 bcm/a was a last minute addition by Yushenko and is not something the Commission plans to push for.

¶8. (SBU) Comment. From our optic, the conference had three positive outcomes: Yushenko and Timoshenko presented a united front, the Russians showed up at the table (albeit to express their objections), and the IFIs made it very clear that investment in Ukraine's gas infrastructure is contingent upon Ukraine moving ahead with reforms. The Russians made at least one valid point: talking about expanding Ukraine's gas transit capacity by 60 bcm/a makes no sense unless you are also talking with the people who would provide the gas to fill that capacity. End Comment.

Murray

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